Case No. D14/86

Board of Review:

William Turnbull, *Chairman*, R. A. Nigel Henley and Woo Man-sing, Manuel, *Members.*

12 August 1986.

Salaries Tax—whether contract gratuity a component of the total income when assessing the value of quarters under Section 9(1) and (2) of the Inland Revenue Ordinance—Person in continuous employment.

The Appellant, a government employee on contract terms, received 25 per cent gratuity upon completion of his contract. Before the expiry of his contract he sought and obtained further employment and his service continued uninterrupted. He was entitled to quarters provided by the Hong Kong Government and he was assessed to tax on such quarters under Sections 9(1) and 9(2) of the Ordinance. The amount of the contract gratuity was included when calculating the value of the quarters for tax assessment purposes because the Assessor considered there was no termination of his employment. The Appellant appealed.

Held:

There was no termination of employment as claimed by the Appellant and gratuity could not therefore be excluded in computing the value of the quarters.

Appeal dismissed.

Chan Wong Yee-hing (Mrs.) for the Commissioner of Inland Revenue.
M. S. Barklem for the Appellant.

Reasons:

This Appeal raises a very interesting point of fact and law which apparently has not been previously decided by either the Board of Review or any Higher Court. It is however a matter of common occurrence in Hong Kong and the Board is much indebted to B and his colleague Mr. Barklem who argued the case on behalf of the Appellant and Mrs. Chan Wong Yee-hing who argued the case on behalf of the Commissioner.

The facts are fully set out in the Determination of the Commissioner and in the Hong Kong Government "Memorandum on Conditions of service for Officers appointed on Overseas Terms" ("the Conditions of Service"). A summary of the facts can be stated quite simply. The Appellant was and is an officer in the Hong Kong Government. He is an

expatriate and was employed on expatriate contract terms. Expatriate contract terms arise and are handled in the following way:—

(i) Following standard procedures of job application interviews etc., the prospective employee is offered employment by the Hong Kong Government in the form of a memorandum of agreement. This memorandum of agreement when signed by the employee and the Government constitutes an agreement of employment and, inter alia, sets out the period of the employment and incorporates the Conditions of Service.

(ii) The Conditions of Service apply to both permanent pensionable employees and contract employees, and therefore it is sometimes difficult to understand their meaning.

(iii) Paragraph 2.3 of the Conditions of Service make it quite clear that the employment of an employee on contract terms ends when the period of the contract terminates. It reads as follows:—

> "In the case when an officer appointed on agreement the appointment will cease on the date of expiry of any leave granted in respect of his agreement."

(iv) A contract employee is entitled to a gratuity of 25% of the total basic salary drawn during the agreement period which is payable at the end of the contract period. (Part of the gratuity is paid immediately prior to the employee proceeding on leave and part is paid on the expiry of the leave but this is not material in the present case.)

The Appellant whilst in the employment of the Government sought and obtained further employment with the Government in accordance with paragraph 24 of the Conditions of Service which reads as follows:—

> "If the officer so requests, the Government will inform him in writing whether it is intended to offer him further employment, subject to satisfactory completion of his current agreement. Such a request should be made between 12 and 9 months before the completion of his current agreement. Any further employment shall be for such period and on such terms and conditions as may be offered by the Government."

The Appellant was entitled to quarters provided by the Hong Kong Government and in accordance with the terms of the Inland Revenue Ordinance he was assessed to tax on such quarters on the notional sum of 10% of his taxable income. This tax was assessed under the provision of section 9(i)(*a*) and section 9(ii) of the Ordinance.

The Appellant was paid his 25% contract gratuity during the year of assessment 1983/1984. It was agreed by both the Commissioner and the Appellant that this gratuity formed part of the taxable emoluments of the Appellant liable to be assessed to salaries tax.

The Commissioner included the amount of the 25% contract gratuity when calculating the value for tax assessment purposes of the quarters provided by the Hong Kong Government.

The Appellant appealed against this assessment arguing that the gratuity should have been excluded form the calculation of the notional rental value of his quarters because the gratuity was a payment which was made to him on the termination of his employment and is expressly excluded by the words of section 9(2) which reads as follows:—

> "The rental value of any place of residence provided by the employer or an associated corporation shall be deemed to be 10 per cent of the income as described in subsection (1)(*a*) derived from the employer for the period during which a place of residence is provided after deducting the outgoings, expenses and allowances provided for in Section 12(1)(*a*) and (*b*) to the extent to which they are incurred during the period for which the place of residence is provided and any lump sum payment or gratuity paid or granted upon the retirement or termination of employment of the employee."

Mr. Barklem put forward a most lucid and concise argument on behalf of the Appellant referring to both the law and the facts, arguing that the 25% gratuity was a lump sum payment or gratuity paid or granted upon the termination of employment of the employee.

The first argument put forward by Mr. Barklem was to rebut a statement of the Commissioner in which the Commissioner had said that the reference in the Ordinance to "retirement" as well as "termination of employment" meant that termination of employment was in some way related to retirement. In this regard we agree entirely with Mr. Barklem and it would appear that the Commissioner likewise agrees with this view because in the reasons given in his actual Determination the Commissioner does not refer to this as a reason for his upholding the assessment. In our view the words "termination of employment" must be construed and interpreted independently and be given their own independent meaning.

The question to be decided is whether there was a termination of employment, at the moment in time when the period of the Appellant's contract of employment with the Hong Kong Government came to an end when he completed his period of resident service in Hong Kong and the period of leave to which he was entitled at the end thereof and immediately prior to his commencing the new period of the further employment to which he and the Government had agreed.

At first sight on reading the wording of paragraph 2.3 of the Conditions of Service it would appear that there was a termination of employment and we would have so found if there had been so supervening events. Paragraph 2.3 of the Conditions of Service is clear and precise. It states that "the appointment will cease on the date or expiry of any leave granted in respect of his agreement". If an appointment ceases then the employment must likewise terminate. However there was a supervening event. Prior to the expiry of the employment agreement between the Appellant and the Hong Kong Government, the parties agreed that the Appellant would be re-engaged or re-appointed for a further contractual

period on the same terms and conditions as then existed subject only to such additional or different terms as the Appellant and the Hong Kong Government then agreed.

The Contractual relationship between the Appellant and the Government was an on-going relationship current at any moment of time. It was a relationship which started as an agreement between the two parties and was then subject to whatever modifications and changes the parties might agree from time to time. It was an original term of the employment of the Appellant that his employment would cease on the date of expiry of his leave in accordance with paragraph 2.3 of the Conditions of Service. Prior to that date he and his employer agreed to change the terms of his employment so that the employment of the Appellant would continue without a break for a further period of time. That being the case we cannot agree with the Appellant when he submits that there was a termination of employment when his leave expired and before his period of further employment commenced.

Having so decided the case for the Appellant must fail and this Appeal must be dismissed.

The logic of assessing the value of quarters supplied by an employer according to his taxable income which includes annual bonuses and in this case periodic gratuities is strange and likewise there appears little justice in the fact that the value of quarters is dependent upon whether or not a person terminates his employment with the Government or seeks an extension. However it is not for this Tribunal to comment on logic or justice but only to apply the law as it is.

For the reasons given this appeal is dismissed and the Decision of the Commissioner is confirmed.